



## STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	<b>04/14/05</b>	Bill No:	<b>SB 392</b>
Tax:	<b>Sales and Use</b>	Author:	<b>Cedillo</b>
Related Bills:			

### BILL SUMMARY

This bill would increase the state sales and use tax rate by 0.50 percent to fund public safety programs.

#### Summary of Amendments

The April 14 amendments provided for an increase in the state sales and use tax rate by 0.50 percent. The revenues derived from this tax would be deposited into the California First Responder Fund, which this bill would create, and used for public safety and emergency services, as specified. The previous version of this bill provided that a county tax collector could sell tax defaulted property in a cash or a deferred payment transaction.

### ANALYSIS

#### Current Law

Under current law, the statewide sales and use tax rate is 7.25 percent. Of the 7.25 percent base rate, 6.25 percent is the state portion and 1 percent is the local portion. The components of the state sales and use tax rate are as follows:

- 5 percent state tax allocated to the state's General Fund (Sections 6051, 6051.3, 6201, and 6201.3)
- 0.25 percent state tax allocated to the Fiscal Recovery Fund (Section 6051.5 and 6201.5)
- 0.50 percent state tax allocated to the Local Revenue Fund which is dedicated to local governments for program realignment (Section 6051.2 and 6201.2)
- 0.50 percent state tax allocated to the Local Public Safety Fund which is dedicated to local governments to fund public safety services (Section 35 of Article XIII of the California Constitution).

In addition to the state portion of sales use tax rate, the following local taxes are imposed by cities and/or counties and are administered by the Board:

- 1 percent Bradley-Burns Uniform Local Sales and Use Tax which is allocated to cities and counties (Part 1.5, commencing with Section 7200).
- Transactions and Use Tax levied at varying rates from 0.125 to 1 percent by some cities, counties, and special taxing jurisdictions in various cities and counties within the state and which are distributed to those local agencies (Parts 1.6 and 1.7, commencing with Section 7251).

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### Proposed Law

This bill would add Sections 6051.7 and 6201.7 to the Revenue and Taxation Code to impose a state sales and use tax at a rate of 0.50 percent. The revenue generated from the sales and use tax rate increase would be transferred to the California First Responder Fund, which this bill would create.

The California First Responder Fund would be added by Section 16419.5 of the Government Code. The moneys in the fund would be allocated as follows: (1) 10 percent of the moneys to the California Highway Patrol and the Department of Forestry and Fire Protection; and (2) the balance would be allocated by statute, on a per capita basis, to each city, county, and city and county for law enforcement and fire department personnel.

Fixed price engineering construction project contracts, building construction contracts, fixed price leases entered into prior to the effective date of the rate increase would be exempt from the rate increase.

The provisions of the bill would become effective immediately. However, the sales and use tax rate increase would become operative on January 1, 2006.

### Background

California's last state sales and use tax increase occurred in July 1991 with the enactment of AB 2181 (Ch. 85, Stats. 1991). The rate was increased by 1.25 percent in response to the budget shortfall.

Prior to that increase, for a 13-month period beginning December 1, 1989 and ending December 31, 1990, a 0.25 percent state sales and use tax increase was enacted in response to the October 17, 1989 earthquake (commonly referred to as the Loma Prieta earthquake) in the San Francisco Bay Area (SB 33x, Ch. 14x, Stats. 1990, First Extraordinary Session).

Other recent measures related to the state sales and use tax rate include Assembly Bill 7x and Assembly Bill 9e. AB 7x (Ch. 13, Stats. 2003) would have increased the state tax rate by 0.5 percent along with a corresponding decrease of 0.5 percent in the local tax rate as of July 1, 2004. However, these provisions were superseded by the passage of Proposition 57 (AB 9e) in the March 2004 Primary Election, which increased the state tax rate by 0.25 percent along with a corresponding decrease of 0.25 percent in the local tax rate, as of July 1, 2004.

### COMMENTS

- 1. Sponsor and Purpose.** This bill is sponsored by the author to provide a revenue source for funding public safety and emergency services.
- 2. The April 14 amendments** provided for an increase in the state sales and use tax rate by 0.50 percent. The previous version of this bill provided that a county tax collector could sell tax defaulted property in a cash or a deferred payment transaction.

3. **Impact of rate change on the Board.** Tax rate changes historically have had a significant effect on the Board. However, this impact is minimized when the rate change takes place on the first day of a calendar quarter and when the Board has sufficient lead time (at least 90 days) prior to the rate change. Since the proposed tax rate increase would become operative on January 1, 2006, the Board should have sufficient lead time to properly inform the public and prepare revised publications and tax returns.
4. **This bill should contain a specific appropriation to the Board.** This bill proposes a sales and use tax rate increase that would take effect January 1, 2006, which is in the middle of the state's fiscal year. An adequate appropriation would be required to cover the Board's costs incurred in administering the tax rate change that would not be identified in the Board's 2005-06 budget.
5. **Partial tax exemptions would apply to the proposed 0.50 percent state sales and use tax.** There are several partial sales and use tax exemptions: farm equipment and machinery, timber harvesting equipment and machinery, diesel fuel used in farming activities and food processing, racehorse breeding stock, property used in teleproduction and post production activities, and the rural investment tax exemption. These partial tax exemption statutes contain provisions that exclude the exemptions from any taxes levied pursuant to the Bradley-Burns Uniform Local Sales and Use Tax Law and Transactions and Use Tax Law. These partial tax exemptions also do not apply to taxes levied pursuant to Section 6051.2 and 6201.2 of the Revenue and Taxation Code (also known as the Local Revenue Fund tax), and pursuant to Section 35 of Article XIII of the California Constitution (also known as the Local Public Safety Fund tax). Therefore, the partial tax exemption statutes only apply to the state General Fund portion of the sales and use tax rate. While the proposed 0.50 percent sales and use tax would not be allocated to the General Fund, since this tax is not specifically excluded from the computation of tax for any of the above mentioned partial tax exemptions, it would be included as part of the exempt rate. As of July 1, 2004, the state rate subject to the partial exemptions is 5.25 percent. If the proposed 0.50 percent increase were to become law, the state rate subject to the partial exemptions would be 5.75 percent.
6. **Proposed 0.50 percent state sales and use tax would not be included in the calculation of the sales tax prepayment rate on motor vehicle fuel, diesel fuel, and aircraft jet fuel.** Suppliers and wholesalers of motor vehicle fuel (gasoline), diesel fuel, and aircraft jet fuel are required to collect a prepayment of a portion of the sales tax when they remove fuel at the terminal rack, enter the fuel into California, or sell the fuels at any point after the removal from the terminal rack. The Board determines the sales tax prepayment rates on these fuels. The rate of prepayment is based on 80 percent of the combined state and local sales tax rate on the average selling price of the fuel as specified in industry publications.

Effective April 1, 2005, the prepayment rates for motor vehicle fuel is \$0.115 per gallon, diesel fuel is \$0.105 per gallon, and aircraft jet fuel is \$0.075 per gallon. These rates are scheduled to remain in effect through March 31, 2006. If the price of these fuels increases or decreases and results in prepayments that consistently exceed or are significantly lower than the fuel retailers' sales tax liability, the Board may adjust the prepayment rates. The Board is required, by November 1 of each year, to establish the prepayment tax rate for these fuels.

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Section 6480.1 of the Revenue and Taxation Code requires the Board to establish the sales tax prepayment rates. The specific language in the statutes provides that “the required prepayment shall be established by the board based upon 80 percent of the combined state and local sales tax rate established pursuant to Section 6051, 6051.2, 6051.3, and 7202 of the Revenue and Taxation Code and Section 35 of Article XIII of the California Constitution on the average selling price as determined by the State Energy Resources Conservation and Development Commission in its latest publication of the Quarterly Oil Report.”

Because Section 6480.1 includes the code sections of each state and local tax component, the proposed 0.50 percent would need to be added to Section 6480.1. Without this amendment to Section 6480.1, the prepayment rate would not take into account the additional 0.50 percent rate resulting in lower than normally required prepayment amounts. It is recommended that Section 6480.1 be amended to reference the proposed 0.50 percent rate increase.

## **COST ESTIMATE**

A detailed cost estimate is pending. However, changes to the tax rates have historically had a substantial impact on the Board’s administrative costs. Returns would require modification to reflect a new rate. It is anticipated that errors on returns would increase which would result in additional workload in the return processing area. Also, programming costs would be incurred to reflect the new rate, in addition to costs to notify all taxpayers registered with the Board prior to the rate increase.

## **REVENUE ESTIMATE**

### **Background, Methodology, and Assumptions**

This bill would increase the state sales and use tax rate by one-half of 1 percent. It would also create the California First Responder Fund and provide that the revenues generated by the one-half of one percent tax increase would be transferred into that fund.

Taxable sales in California for 2004-05 are estimated to be \$498.9 billion.

### **Revenue Summary**

The annual revenue gain from increasing the sales and use tax one-half of 1 percent would be \$2.5 billion (\$498.9 billion X 0.005).

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